

Except for automobiles leased for a period of one year or less, lessors of tangible personal property in Illinois under true leases are considered to be the end users of the property to be leased, and the lessors incur Use Tax liability on the lessors' cost price of the property. See, 86 Ill. Admin. Code 130.220. (This is a GIL.)

December 1, 1998

Dear Ms. Xxxxx:

This letter is in response to your letter dated June 15, 1998. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We are an STATE based corporation located in CITY/STATE. We are leasing pipeline construction equipment to a contractor who has a job in Illinois.

According to the information I received from your tax specialists on June 15, 1998, since our equipment has been depreciated out, we are not liable for any type of tax, i.e. corporate, income, or sales, on the lease of our equipment.

We also understand that we will owe no business income tax since we have no actual presence in the state of Illinois.

In the event that we sell merchandise to our customer in Illinois, we understand that we will need to collect and remit a sales tax of 6.25%.

I am requesting that you please send me a letter stating that this information is correct, for my tax records.

#### LEASES

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: true leases and conditional sales.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this

transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois, are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. No tax is imposed on rental receipts by the State of Illinois. Consequently, lessees incur no tax liability.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers are registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

The "selling price" (cost price) of the leased property for Use Tax purposes is reduced by an amount which represents a reasonable allowance for depreciation if such property was acquired outside Illinois and was used outside Illinois before being brought into Illinois for use. See 86 Ill. Adm. Code 150.105 and 150.110, enclosed.

#### SALES TO ILLINOIS CUSTOMERS

Please find enclosed Form NUC-1, Illinois Business Registration, which is used to register with the Department. Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act, 35 ILCS 120/1 et seq. (1994 State Bar Edition), imposes a tax upon persons engaged in the business of selling tangible personal property at retail. The Use Tax Act, 35 ILCS 105/1 et seq. (1994 State Bar Edition), imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer.

An Illinois retailer is anyone who either accepts purchase orders in Illinois or who sells items of tangible personal property which are located in Illinois at the time of sale. See the enclosed copy of 86 Ill. Adm. Code 130.605(a). The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred

by the purchasers at the rate of 6.25% plus any local taxes applicable to their selling locations.

In general, the imposition of the various sales tax related local taxes in Illinois are triggered when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115(b), enclosed. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred.

If a purchase order is accepted outside the state, but the property being sold is located in an Illinois jurisdiction that has imposed a local tax (see, for example, Section 270.115(b)(3)), then the location of the property at the time of sale will determine where the retailer is engaged in business for the purpose of determining the imposition of applicable local sales taxes.

So long as a seller does not accept purchase orders in Illinois, and so long as the items it sells are not located in Illinois at the time it sells them, it need not register as an Illinois retailer.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability. Please note that out-of-State retailers with any kind of representative in Illinois (not just sales or lease agents) are required to register as out-of-State Use Tax collectors.

The final type of retailer is simply the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax law. A retailer in this situation does not incur Retailer' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's sales tax laws. The Supreme Court has set out a two-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due Process will be satisfied if the person or entity purposely avails himself or itself of the benefits of an economic market in a forum state. *Id.* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause.

A physical presence does not mean simply an office or other physical building. Under Illinois tax law, it also includes the presence of any representative or other agent of the seller. The representative need not be a sales representative and it is immaterial for tax purposes that the representative's presence is temporary.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton  
Associate Counsel

TDC:msk  
Encl.